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TAGS: ECON EAGR VE
SUBJECT: VENEZUELA WAKES UP AND SMELLS THE COFFEE

This message is sensitive but unclassified, please treat accordingly.

SUMMARY

¶11. (U) After the BRV doubled the price roasters had to pay farmers for raw coffee beans, and fixed the price of ground coffee below cost, a nationwide shortage of ground coffee took effect in late December 2005. Roasters refused to sell their product at a loss and hoarded it in an attempt to pressure the government into raising the fixed price. President Chavez responded by ordering the seizure of ground coffee and threatening roasters with expropriation of their plants. On Jan 17, after one month of empty shelves, the BRV finally buckled and raised the price of ground coffee roasters were permitted to charge by 60 percent. Other price-controlled products, such as powdered milk, sugar, and corn flour, have undergone similar disruptions. BRV retrograde pricing policies, incompetence, and concerns about increasing prices this political year have led to price distortions and shortages of staple products. End Summary.

BACKGROUND: COFFEE IN VENEZUELA

¶12. (U) The Venezuelan coffee market is largely domestic) there have been no imports since 2004, and an export ban was in place until that same year, though exports today are minimal. Ground coffee has been price-controlled since 2003. Seven years ago, Venezuela had a total of 83 roasting companies, 73 of which were small and medium companies covering 40 percent of the market. Today there are only 23 companies, two of which cover 83 percent of the market. This concentration of ownership has, according to ASICAF, the coffee producers' association, resulted in over 80 percent of coffee growers living in poverty. Small growers are dependent on large companies to sell their harvests.

¶13. (U) Since Chavez came to power, the BRV has attempted to control the coffee market and production. In Nov 2005, the government established a state-owned processing plant, "Cafe Venezuela," to supply Mercal, the state-owned food chain with over 30 percent of market share for food sales. A year earlier, the government launched Plan Cafe, a program aimed at providing financial assistance to small growers and regulating distribution. The lack of clear objectives or

definition caused the plan to fall short of expected results, so the BRV unveiled a Socialist Coffee Plan in late 2005 -- an "endogenous development model" promising to bring social and economic benefits to growers, reduce prices, and guarantee production. The Minister of Agriculture also announced the creation of a Venezuelan Agrarian Coffee Corporation intended to cut out middlemen and facilitate market access.

DIARY OF A COFFEE CRISIS

¶4. (U) On December 1, the government provoked a coffee crisis by raising the price of all ground coffee varieties by 66 percent. Two weeks later, on Dec 16, the BRV raised the price of raw coffee beans by 102 percent, after eight years without price increases for this commodity. Before these actions, regular ground coffee was selling in supermarkets well above the fixed price set in 2004, as roasters evaded price controls by re-labeling their products as non-regulated varieties. However, since the BRV made a show of enforcing fixed prices by fining and temporarily closing over 75 businesses in early December, roasters took heed of the new price and complained.

¶5. (SBU/F) According to the head of purchasing for Fama d America (a large coffee company), Eduardo Margaet, on Dec 8 the ministers of Agriculture and Lans, Light Industry, and Food agreed to a meeting ith roasters. Plant owners explained that the nw ground coffee rate was well below their costs;nonetheless the BRV a week later published the nw higher raw bean price. Within days, roasters stoped

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distributing their product and street vendors were selling ground coffee on the black market at a 170 percent markup. According to Margaret, the inability of top-level officials to determine a timely, adequate price change directly caused the shortage. Despite BRV public statements to the contrary, even Mercal stores reported shortages, as the state-owned Caf Venezuela held out for ground coffee price increases just like private roasting companies.

¶6. (U) In his weekly address on Jan 8, Chavez sternly warned roasters not to "hide" coffee as it "belonged to the people of Venezuela," and threatened to expropriate roasting plants and seize existing supplies. By Jan 11, the National Guard and the Institute for Consumer's Rights (INDECU) seized 1,929 tons of coffee for distribution in the Mercal network. According to Fama De America, authorities "negotiated" a sale at near or below the fixed price for the seizure. Attempts to artificially keep basic food basket prices low are part of Chavez' overall political agenda, which caters to his largely low-income voter base. By week four of the crisis, and only after loud public outcry on the issue, the Ministry of Light Industry and Commerce caved and raised the price of ground coffee by 60 percent. INDECU reported on Jan 26 that the market was back to normal, but industry said it would take a month due to delays in new pricing margins and pending disagreements over transport costs and grain classification. By early February, the product started slowly reappearing on shelves.

THE FOOD BASKET EMPTIES

¶7. (U) Coffee isn't the only product that has experienced shortages, thanks to bumbling of BRV efforts to control prices. CAVIDEA, the Venezuelan Chamber of Food Industries, noted that in 2005 the volume of price-controlled product sales dropped every month. The industries that produce these products identified low profit margins, high raw material prices and lack of domestic availability of raw materials as their biggest problems over the last year. Fedeagro, the

Federation of Agricultural Producers, has been so unhappy with government pricing that they staged a large protest in front of the Presidential Palace on Feb 9.

¶18. (U) Powdered milk and sugar are also in short supply. Venezuela imports nearly the same amount of milk as it produces even though this industry grew seven percent last year. According to the president of Chamber of Dairy Industries (CAVILAC), import licenses are a bureaucratic nightmare to obtain. As of Jan 12, in response to shortages, INDECU had seized 189 tons of powdered milk from various warehouses. According to press reports, Venazucar, a sugar producers' and refiners' association, as well as INDECU, believe the refined sugar shortage is due to truckers choosing other products after the BRV suspended a transportation subsidy on Dec 1. However, the sugar cane farmers' federation (FESOCA), reports that shortages are due to a rainy winter and farmers failin to buy high-priced imported raw materials.

9.(U) White corn flour, a staple of the Venezuelan iet, has also become an absentee member of the bsic food basket. On Dec 1, the BRV raised the prce of raw corn 9 percent despite demands from Fedeagro for a larger price increase. Processing companies such as Polar Foods are asking for a 41 percent price increase for corn flour, noting that since price controls began, raw corn has risen 107 percent versus only 66 percent for corn flour. (Note: Inflation for 2004 and 2005 was 19.2 and 14.3 percent, respectively. End note).

The corn flour market is dominated by Proarepa (a government-subsidized producer that supplies to Mercal) and Polar Foods (a private company), the latter operating at a loss using last year's harvest and reportedly only having a 10 day supply left. By Jan 17, industries estimated that 50 percent of the harvest was sitting unprocessed in silos.

¶10. (U) The shortage/price distortion pattern caused by BRV actions repeats itself in a myriad of other products. Black beans are selling on the black market at 48 percent above the fixed price; rice and sorghum prices are fixed below cost; bread and pasta are dependent on imported raw materials yet

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have unrealistic fixed prices; chicken and beef each sell on the black market at 20 percent above controlled prices. Though many of these products can be found at grocery stores and in street stalls, prices fluctuate wildly as does availability.

BRV SNUBS PRIVATE SECTOR

¶11. (SBU/NF) According to the president of Fedeagro, Gustavo Moreno, the BRV mistrusts the private sector and directly caused shortages through "incompetent and incoherent" pricing decisions and policies. (Note: Fundamentally the BRV wants to maintain fixed prices on certain staple products without taking into account increasing factor costs as stipulated by the Agricultural Marketing Law, which requires consensus among producers, industry and government for price modifications. Additionally, the BRV is squeezing growers by delaying release of harvest prices. End Note). Though Moreno met with senior BRV officials often and presented production and cost figures to support certain price increases, he felt his clamoring fell on deaf ears until other factors (such as public opinion) prompted eventual action. He also noted that final decision-making seemed to be centralized at the highest levels, and that information provided by the private sector was considered "suspect" by the BRV until it could be corroborated by other sources, if at all.

¶12. (U) After prompting by Chavez, the National Assembly drafted a law that would penalize hoarding and price speculation and has created commissions to study market

distortions. The BRV has promised to achieve "food sovereignty" in 10-12 years (domestic production to cover domestic demand), a plan aimed at reducing import dependency, as Venezuela imports roughly 70 percent of food products. (Note: Chavez is also looking to import sugar, corn and milk processing plants for "endogenous development" projects and to put further pressure on private agricultural interests. End Note).

COMMENT

¶13. (U) BRV attempts to hold down prices have produced detrimental effects for staple food prices and availability, and ironically have made the products needed by the poorest sectors a luxury to find and pay for. These policies appear to be driven by populist election year politics of allowing only minimal price increases for basic food staples. Chavez' solutions to the problem - imports, confiscations and threats of nationalization, threatening the establishment of "endogenous" parallel production facilities - are a clear attempt to intimidate private sector suppliers into keeping prices low, but fail to address the realities of market forces. Though the BRV promises to achieve "food sovereignty," that goal seems well out of reach as growers, roasters, refiners, and processors who supply price-controlled products are finding an increasingly difficult operating environment. While the political damage for the Chavez administration is uncertain, and perhaps only transitory, these inept pricing policies have resulted in highly-visible and unpopular product shortages throughout the country. End comment.

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